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SUBJECT: ARGENTINA ECONOMIC AND FINANCIAL REVIEW, JULY 6 -
13, 2007

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1. (U) Provided below is Embassy Buenos Aires' Economic and
Financial Review covering the period July 6 - 13, 2007. The
unclassified email version of this report includes tables and

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charts tracking Argentine economic developments. Contact
Econoff Chris Landberg at landbergca@state.gov to be included
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Highlights

-- Central Bank (BCRA) tightens capital controls to avoid
peso appreciation
-- BCRA meets its monetary targets for sixteenth consecutive
quarter
-- GoA, unions, private sector agree to increase monthly
minimum wage 22.5%
-- GoA's intervention in private energy company MetroGas

Banking and Finance

BCRA tightens capital controls to avoid
peso appreciation

¶2. (SBU) On July 5, the Argentine Central Bank (BCRA) issued a circular (A 4687) to tighten capital controls in order to discourage capital inflows and avoid the peso from appreciating. The measure, which generated much confusion in the market due to its complexity, seeks to discourage the so called "contado con liquidacion" (AKA "Blue Chip Swap") transaction, which investors use to avoid capital controls and arbitrage international and domestic exchange rate differentials. The transaction generally begins when an investor purchases an Argentine bond (denominated in either pesos or dollars, but purchased with pesos at the local exchange rate). The investor then transfers the bond to a foreign market (e.g. the U.S. or Europe) through EuroClear or some other securities settlement system, and then sells it for dollars at the international exchange rate. The investor then gradually transfers the proceeds back to Argentina in denominations of less than \$2 million -- circumventing the 30% unremunerated reserve requirement ("encaje") to which capital inflows are subject as part of the GoA's capital controls -- and then converts the dollars back to pesos at the local exchange rate.

¶3. (SBU) The point of this trade is to arbitrage the lower international peso exchange rates (caused largely by the GoA's existing capital controls) against the higher domestic exchange rate. However, the result is a steady inflow of foreign currency, putting upward pressure on the peso. The BCRA's new measure requires proof that the Argentine bond used in such a transaction has been held for at least 20 days in a foreign account. In theory, this delay should raise exchange rate risks enough to discourage the arbitraging. However, in practice the participating banks and brokers are scrambling to determine how to demonstrate proof of the incoming monies' origins. Post's market sources argued that

the impact of the measure will be short-term, since investors will quickly find creative new ways to circumvent the controls.

BCRA meets its monetary targets for sixteenth consecutive quarter

¶4. (SBU) The BCRA announced July 10 that it fulfilled its monetary target for the second quarter of 2007, the sixteenth consecutive quarter that it has met its targets. The 2007 BCRA Monetary Program targets M2, which is defined as cash in circulation plus private and public sector sight-accounts (savings and checking). According to preliminary BCRA data, the average M2 level during the quarter was ARP 132.3 billion, ARP 3.1 billion below the upper limit of ARP 135.4 billion established in the 2007 Program, and ARP 3.4 billion above the lower limit of ARP 128.5 billion. At the end of June M2 was above the upper band, and the average M2 level during the month was only ARP 1.0 billion below the upper limit.

¶5. (SBU) According to local analysts, the BCRA achieved its M2 target by shifting public sector funds from sight accounts to time deposits (not counted in M2). However, the BCRA appears to have attempted to disguise the actions it took to meet the target. Its July 10 press release made no mention of the transfer of public funds. Rather, it argued that time deposits increased at a faster rate (31%) than sight deposits (18%) in response to BCRA policy of increasing short term repo rates, which led to an increase of time deposit yields. However, the explanation is not consistent with market data, which show falling time deposit rates over 2007.

¶6. (SBU) In its release, the BCRA highlighted that during the first half of the year it sterilized 80% of the monetary expansion generated by its purchases of foreign currency inflows (technically part of its reserve-building strategy, but in reality done to prevent the peso from appreciating). The BCRA faces a difficult task in meeting its M2 targets for the remainder of 2007, if it continues to accumulate reserves at the current pace. The problem is that it is becoming

harder for the BCRA to sterilize its interventions without raising interest rates on its main instruments -- Lebac's (fixed-rate) and Nobac's (variable-rate). (Note: in the BCRA's July 10 auction, it was able to rollover only 60% of its maturities. The BCRA received bids for ARP 677 million and accepted bids for ARP 626 millions, well below its maturities for ARP 1.1 billion.)

Economic Outlook

GoA, unions, private sector agree to increase monthly minimum wage 22.5%

17. (SBU) The Salary Council -- made up of representatives of the private sector, the unions and the Labor Ministry -- agreed July 10 to increase by 22.5% the monthly minimum wage to ARP 980. The increase will be implemented in three steps: from the current ARP 800 to ARP 900 in August, following by an increase to ARP 960 in October, and a final hike to ARP 980 in December. The unions had originally sought a minimum wage of ARP 1,040, while business sector was offering ARP 930. According to media reports, GoA intervention convinced

both sides to agree to the ARP 980 level. The wage increase will benefit an estimated 420,000 individuals, roughly 3.8% of all wage-earners (including informal sector employees).

18. (SBU) With this increase, the monthly minimum wage will be close to the total monthly cost of the basic good basket -- necessary to maintain a household of two adults and three children -- which "officially" (according to GoA statistical agency INDEC) reached ARP 923 in June. However, according to Consultora Equis (a local think-tank) the basic good basket valued at ARP 923 in June is 10% undervalued and its "real" cost is ARP 1,011. INDEC's undervaluation of the basic foods basket is a result of its manipulation of CPI numbers, which the GoA has carried out since the beginning of the year to avoid showing real inflation. (Note: INDEC reported inflation of 3.9% through the end of June, compared to private sector estimates of 8-10%).

Energy Outlook

GoA's intervention in private energy company MetroGas

19. (SBU) On July 6, the Economy Ministry's Secretary of Internal Commerce Guillermo Moreno, Argentina's notorious price control czar, instructed MetroGas' Director General Roberto Brandt, to reverse his decision to cut natural gas provision by 35% to MetroGas' industrial clients, including those whose contracts with MetroGas only allowed for supply interruptions under extreme circumstances ("contratos no interrumpibles con ventanas"). Brandt requested a written order from Moreno, as the 35% cuts were in line with earlier written instructions from the Secretariat of Energy's crisis committee, aimed at increasing natural gas deliveries to residential consumers. Moreno responded by "intervening" MetroGas (taking it under State control), justifying his actions based on the GoA's "Mandatory Supply law" (Law 20680 or "ley de abastecimiento"). Moreno argued that this law allowed him to intervene a company up to 180 days if it does not supply enough of a product to meet market demand.

110. (SBU) Legal experts question the legality of the Supply law, but also argue that the Secretary of Energy and natural gas regulatory agency, ENARGAS, should have jurisdiction in this area. Planning Minister Julio De Vido, who oversees the Secretary of Energy and ENARGAS, lifted the intervention only

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a few hours after Moreno had announced it. MetroGas' stock price, traded in both Buenos Aires and New York fell by almost 10% following the intervention, but ended the day

(after Minister De Vido's announcement) down only 4.2%.

¶11. (SBU) While announcing the end of the intervention, the Ministry of Planning also announced that MetroGas shareholders had subsequently removed Brandt as Director General and replaced him with the second-in-command of the firm, Vito Camporreale. (Note: Consorcio Gas Argentino Sociedad Anonima, in which British Gas Group holds almost a 55% stake, owns 70% of MetroGas, while Repsol-YPF owns the remaining 30%. Brandt is said to have been appointed by British Gas, whereas Camporreale is a Repsol man.)

¶12. (SBU) The Argentine press interpreted the MetroGas event, as follows:

-- Evidence that the GoA does not have an agreed-upon strategy to deal with the energy crisis. (Note: on one side is Secretary of Energy Daniel Cameron, who supports dealing with the crisis with higher user fees. President Kirchner and Minister De Vido (and, therefore, Moreno, De Vido's protege) strongly oppose this strategy. Local analysts speculate that President Kirchner believes that having Argentine ownership of energy sector firms (e.g., Repsol's proposed sale of 25% of YPF to a local investor and 20% on the Argentine stock market) will help the GoA limit the impact of the energy crisis. End Note)

-- A struggle for power between the Secretariat of Energy and the Secretariat of Internal Commerce. (Note: The Argentine press has speculated that Energy Secretary Daniel Cameron is a possible replacement for Planning Minister De Vido if/when Cristina Fernandez de Kirchner is elected President in October. End Note)

-- MetroGas Director Brandt's removal is evidence of strengthening ties between the GoA and Spanish-owned Repsol (Note: President Kirchner is rumored to have suggested Enrique Eskenazi, President of Banco de Santa Cruz, as the local party in the acquisition of 25% of YPF. End Note)

-- This could also be a means for the GOA to penalize British Gas. (Note: British Gas has taken Argentina to international arbitration under UNCITRAL rules, demanding \$200 million in damages related to the GoA's 2002 currency devaluation. British Gas rejected a GoA proposal to terminate the arbitration case in exchange for a re-negotiation of fees. End Note)

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